

4.3 The role of domestic factors

Learning Outcomes

- With reference to a specific developing economy, and using appropriate diagrams where relevant, examine how the following factors contribute to economic development:
 - a) Education and health.
 - b) The use of appropriate technology.
 - c) Access to credit and micro-credit.
 - d) The empowerment of women.
 - e) Income distribution.

Discussed below are some of the factors that contribute to economic development.

Subject vocabulary

private benefits the benefit firms or consumers receive from their own production or consumption of a good

external benefits occurs when the production or consumption of a good causes a benefit to third parties

civil society the sum of all non-governmental organizations and institutions

economically active describes people of working age who are employed or actively seeking employment

human capital this relates to the store of knowledge and the set of skills that a worker possesses which can be used in the production process. The higher the value of human capital the more productive the worker is. Human capital can be improved through investment in education and training.

productivity of labour the quantity of goods that a worker produces in a given period of time

long-run economic growth an increase in the productive capacity of a country

national income the sum of all income (wages, profits, rents, and interest) earned in a country in a given period of time

economic growth an increase in real GDP

GDP gross domestic product is the monetary value of all the finished goods and services produced within a country in a given period of time, usually measured over a year

How does education and health contribute to economic development?

There are **private benefits** and **external benefits** of education and health. The private benefits of education enjoyed by individuals include the ability to read and write, and therefore the ability to earn a higher income from their labour. There is a strong relationship between educational attainment and income earned. People also benefit from the enjoyment that comes from reading and writing. People can communicate effectively with one another leading to an expansion of **civil society**. There is also a strong relationship between the educational attainment of women and birth rates. Educated women tend to have fewer children and are therefore more likely to be **economically active**.

External benefits are the benefits enjoyed by society from having a well educated population. A country needs people with skills – such as mechanics, engineers, teachers, and doctors – if it is to develop and grow. Investment in **human capital** through education and training increases the **productivity of labour**, which is an important determinant of **long-run economic growth**. Countries with relatively high **national income** invest heavily in the provision of educational services.

There is a strong relationship between **economic growth** and educational attainment. In Pakistan literacy rates have steadily increased. In 1951 the adult literacy rate was 16.4% and by 2012 it had increased to 69.66%. Pakistan has experienced economic growth over these years, some of which was caused by increases in educational attainment. The graph in Figure 82.1 shows GDP in Pakistan from 2004 to 2012.

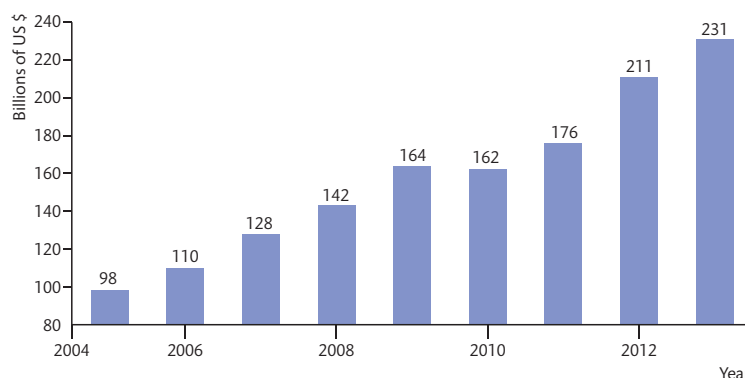


Figure 82.1 Source: www.tradingeconomics.com

Although there have been increases in literacy rates they have been slow and are now increasing at a decreasing rate. Female literacy rates are relatively low at 55% which harms prospects of development and growth. Less developed countries spend a relatively smaller proportion of **GDP** on education than do more developed countries. For example, Pakistan spends 2.7% of its GDP on education while Norway spends 6.8% of its GDP on education.

There are private benefits enjoyed by healthy people. They can live more of their lives free from pain and disease and they are able to continue to work for longer, thereby earning higher income. There are also external benefits enjoyed by society. The quality of human capital is an important determinant of economic development and growth.

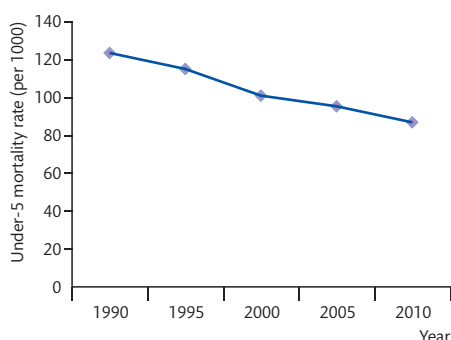


Figure 82.2 Source: Index Mundi

This graph shows that the under 5 years old mortality rate per 1,000 births fell from over 120 in 1990 to about 80 in 2010 and has continued to fall. Despite the fall in rates Pakistan has one of the highest child mortality rates in South Asia.

Life expectancy during this time has steadily increased and in 2013 it was 65 years. Increases in life expectancy, literacy rates, GDP per capita, and falls in the child mortality rate have led to an increase in Pakistan's HDI.

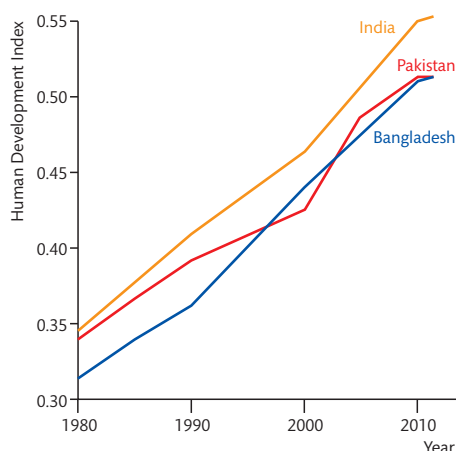


Figure 82.3 Source: UN Human Development Report 2013

It can be seen in this graph that Pakistan's HDI has increased from under 0.35 in 1980 to over 0.5 in 2010. Its neighbouring countries' HDI have increased in similar ways.

Unsurprisingly, LDCs spend a smaller proportion of GDP on health services than developed countries. Pakistan spends 2.2% of its GDP on health services and has 0.8 doctors per 1,000 people. In Norway there are 4.2 doctors per 1,000 people and it spends 9.2% of its GDP on health services.

Model sentence: An increase in investment in education and health leads to an increase in productivity and higher income per capita.

Why is the availability of credit and appropriate technology important for economic development?

The availability of **credit** is the most important determinant of entrepreneurial activity. An individual might have a good idea for a business but the idea cannot be turned into a real business without **start-up capital**.

In developed countries national income is relatively high. Higher income earners are able to put money into **saving accounts**. Banks therefore are able to lend to potential **entrepreneurs**. In low income countries households spend nearly all their income on satisfying needs, therefore, not very much money is saved and not much money is available for lending. In many regions of poor countries there are no banks. Credit is also needed by existing businesses to buy **capital** that will increase their **productivity**.

Productivity in agricultural output in developing countries such as Pakistan is relatively low. This is because farms in Pakistan are small and farmers are unable to benefit from technical **economies of scale**. Farmers do not have the money to invest in more **technologically advanced capital**. Agricultural output therefore earns farmers a low income from which they are unable to save. Availability of credit is needed if farmers are to break out of this cycle of low income and low productivity. A productive agricultural sector is needed to meet the higher demands of a growing industrial, urbanized, developing economy.

Model sentence: Businesses in LDCs have high **average fixed costs** due to low productivity. Without higher income or access to credit they are unable to invest in new capital therefore labour productivity and income remains low.

Micro-credit refers to relatively small loans, of a few hundred dollars, offered to groups or individuals by international financial institutions. Many women, who are unable to obtain credit in other ways, make use of micro-credit. The money is usually used to start up small businesses.

Subject vocabulary

credit an agreement in which a person or business borrows money, usually from a bank, and agrees to pay back the lender the sum borrowed plus the interest within an agreed period of time

start-up capital money that is needed to set up a new business

saving accounts a bank account which pays interest on deposits

entrepreneurs an individual who, in pursuit of profit, brings together the other factors of production in order to produce a good or service

capital (goods) manufactured goods that are used in the production of other goods

productivity the quantity of output per unit of input

economies of scale the fall in average cost in the long run brought about by an increase in the size of a firm's operation

technologically advanced capital capital that incorporates new technology and is used in place of existing capital to produce goods and services thereby increasing productivity

average fixed costs equal to total fixed cost divided by quantity of output

Subject vocabulary

interest rate the percentage amount charged by a lender for money borrowed or paid to a person for saving money

unemployment occurs when there are people actively looking for work at the equilibrium wage rate but are not able to find work

labour market a market in which firms demand labour and workers supply labour. The interaction of demand and supply of labour determines the equilibrium wage.

technological unemployment unemployment caused by technological changes. It occurs when capital replaces labour in the production of goods.

intermediate technology technology that is appropriate for use in less developed countries that allows making use of the country's available resources and skills

labour-intensive describes production that requires a large amount of labour relative to the amount of capital

labour participation rate the percentage of the working-age population who are employed or actively seeking employment

GDP per capita equals gross domestic product of a country divided by the population

resources the inputs into the production process, the factors of production

progressive tax system a system of taxation in which the rate of tax increases with income

The loans require very little paperwork to organize but are sometimes time consuming and costly to administer because the loans go to people who live over a large geographical area, often in remote places, and because of this a relatively high **interest rate** is charged on micro-credit loans. Most are short-term loans due for repayment within the year.

Once a business has started to grow, and is profitable, entrepreneurs are able to borrow more money to enable the business to expand. The lenders in most countries are regulated by government and, although relatively high interest rates are charged on loans, borrowers do not have to borrow from unregulated money lenders who charge very high day lending rates and who sometimes use violence and other threats to ensure repayment of loans.

Model sentence: Micro-credit allows ideas to become small businesses which can grow to make a valuable contribution to a developing country's GDP.

Many developing countries have high levels of **unemployment**. Supply of labour onto the **labour market** exceeds demand for labour. Some economists believe that the introduction of technologically advanced capital at this stage of development is not appropriate because workers do not have the skills necessary to effectively use modern capital and workers currently employed would be replaced with capital, leading to **technological unemployment**. It has been argued that developing countries should employ **intermediate technology** that is more suited to the needs of LDCs. Capital employed should not require a high level of skill to operate it or maintain it.

Model sentence: Developing countries have a surplus of low skilled workers therefore intermediate technology appropriate for **labour-intensive** production should be used by businesses to ensure higher levels of employment.

Why would increasing gender equality contribute to economic development?

In the developing world many more women than men are not in the labour market. The female **labour participation rate** in Pakistan was 28% in 2013. The female participation rate in the US was 60%. The World Development Report by the World Bank, published in 2013, stated that 80% of Pakistani women believed family household duties and a lack of education were the causes of their non-participation in the labour market. Pakistan has the world's second-highest number of children not attending school, more than 5 million. More than 3 million of those not attending school are girls. Religious groups in some developing countries discourage girls from going to school, often threatening violence against those who try to attend.

Societies in many LDCs are very inequitable. Women are discriminated against in many ways. About 52% of the population in Africa are women and in 2013 it is estimated that on average women did about 75 percent of the agricultural work but earned only 10% of income. Most land is owned by older men, women own about 1% of the continent's assets. In most developed countries women have equal access to education and health services; this is not the case in LDCs. There is a strong relationship between education and birth rates. The more educated tend to have fewer children, and this means they are more likely to enter the labour market. The quantity and productivity of women in the labour market over the years in developed countries has led to an increase in **GDP per capita**.

Model sentence: Educating women leads to a fall in the birth rate and an increase in the labour participation rate.

The United Nations monitors gender equity in developing countries and, through discussion with politicians, encourages them to introduce policies that will reduce gender discrimination.

Model sentence: Low educational attainment and a low labour participation rate amongst women is a waste of the world's scarce **resources**. Empowering women in developing countries would lead to increases in GDP per capita and a reduction in poverty.

Why would reducing income inequality contribute to economic development?

A **progressive tax system** is used in developed countries in order to redistribute income. For example, by increasing the tax rate as income increases Norway has redistributed income away from those on high income to those on low income, making the distribution of income more equal. GDP is relatively high, therefore the

government can collect and spend **tax revenue** to provide all citizens with education and health services, making society more equitable. Spending on education and health improves the **productivity of labour**, leading to increases in **GDP** and economic development.

Governments in developing countries are unable to distribute income more equally for a number of reasons. In developing countries GDP is low, limiting the amount of tax revenue governments can raise. A high proportion of economic activity takes place in informal markets. Income earned in these markets is not taxed. And because there are relatively few companies operating in developing countries taxes raised from company profits is low.

The **bureaucratic** infrastructure necessary to effectively collect taxes does not exist in many LDCs. Without an effective system of collecting taxes backed up with a legal structure to ensure payment, **tax avoidance** is high.

In many developing countries **wealth**, land, and **capital** are owned by a very small proportion of the population and there is a large gap between the educational attainment of the rich and the poor. Along with the absence of effective progressive taxation it is not surprising that the distribution of income is very unequal.

Many East Asian countries have experienced high levels of economic growth, along with increasing income equality. Governments have introduced progressive taxation and have invested in **human capital** and **physical capital**, including **transport infrastructure**.

Economic growth and the continued redistribution of income has provided an opportunity for more people to save leading to a more equal distribution of wealth and increases in **investment**.

A more equal distribution of income leads to greater political stability. Many developing countries have a very unequal distribution of income. A large proportion of the population do not have the opportunity to raise their **standard of living**. There are no **transfer payments** from government to households to help support poor and unemployed families. This can lead to social and political unrest.

Model sentence: A more equal distribution of income leads to greater social stability and increases in the rate of savings and investment.

Subject vocabulary

tax revenue the income the government receives through the levying and collection of taxes

productivity of labour the quantity of goods that a worker produces in a given period of time

GDP gross domestic product is the monetary value of all the finished goods and services produced within a country in a given period of time, usually measured over a year

tax avoidance a practice of using legal means to pay the least amount of tax possible

wealth the total monetary value of all assets, including property, shares and savings that a person owns

capital (goods) manufactured goods that are used in the production of other goods

human capital this relates to the store of knowledge and the set of skills that a worker possesses which can be used in the production process. The higher the value of human capital the more productive the worker is. Human capital can be improved through investment in education and training.

physical capital any manufactured good that is used in the production of other goods and services such as machinery and buildings

transport infrastructure the physical capital that supports a transport system such as roads, railways, ports, airports

investment the addition to capital stock

standard of living the level of well-being of a person or groups of people

transfer payments a payment of money for which nothing is received in exchange

Glossary

bureaucratic involving many official processes/rules